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Wells Fargo Funding, Inc.

10 **IN THE UNITED STATES BANKRUPTCY COURT**
11 **FOR THE DISTRICT OF ARIZONA**

13 In re:

14 **FIRST MAGNUS FINANCIAL**
15 **CORPORATION**

16 Debtor.

Chapter 7

Case No.: 4-07-bk-01578-JMM

OBJECTION OF WELLS FARGO
FUNDING, INC. TO
CONFIRMATION OF THE
SECOND AMENDED PLAN OF
LIQUIDATION FILED BY FIRST
MAGNUS FINANCIAL
CORPORATION DATED
JANUARY 4, 2008

Date: February 7 and 8, 2008
Time: 9:30 a.m.
Place: Tucson, Arizona

22 Wells Fargo Funding, Inc. ("Wells Fargo Funding") hereby files this
23 objection (the "Objection") to confirmation of the Second Amended Plan of Liquidation
24 filed By First Magnus Financial Corporation (the "Debtor") dated January 4, 2008 (the
25 "Plan"). In support of its Objection, Wells Fargo Funding respectfully states as follows:
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1 **FACTUAL BACKGROUND**

2 4. On August 21, 2007 (the "Petition Date"), the Debtor filed a
3 voluntary petition for relief under chapter 11 of title 11 of the United States Code (the
4 "Bankruptcy Code").
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6 5. Prior to the Petition Date, the Debtor entered into agreements with
7 Wells Fargo Funding that set forth the essential terms governing the sale of certain
8 mortgage loans from the Debtor to Wells Fargo Funding.
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10 6. Specifically, Wells Fargo Funding entered into two prepetition loan
11 purchase agreements with the Debtor pursuant to which Wells Fargo Funding purchased
12 certain qualifying fixed and adjustable rate residential first lien mortgage loans (the
13 "Mortgage Loans") from the Debtor. The agreements include: (1) the Master Mortgage
14 Loan Purchase and Interim Servicing Agreement, dated August 29, 2006 (as amended,
15 restated, supplemented or otherwise modified from time to time, the "MLPSA"), which
16 is attached hereto as Exhibit A, and (2) the Loan Purchase Agreement, dated August 16,
17 1996 (as subsequently amended, the "Loan Purchase Agreement"), which is attached
18 hereto as Exhibit B.¹ The Loan Purchase Agreement incorporates by reference the
19 Wells Fargo Funding Seller Guide (as amended, restated, supplemented or otherwise
20 modified from time to time, the "Seller Guide"), which sets forth additional terms and
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25 ¹ The Loan Purchase Agreement has been amended several times including: (1) the Zip Fund Delayed Program
26 amendment, dated November 6, 2003 (the "Zip Fund Amendment"); (2) the First Amendment to the
27 Institutional Conduit Program Purchase Agreement, dated December 1, 2005 (the "First Conduit
28 Agreement"); (3) the Image Express Program Amendment, dated July 31, 2006 (the "Image Express
Amendment"); (4) the Second Amendment to the Institutional Conduit Program Purchase Agreement, dated
January 10, 2007 (the "Second Conduit Amendment"); and (5) the Conventional Delegated Underwriting
Amendment, dated May 23, 2007 (the "CDU Amendment"). The foregoing list is not intended to be the
exclusive list of amendments to the Loan Purchase Agreement, and any reference to the Loan Purchase
Agreement includes any subsequent amendments thereto, irrespective of whether such amendments are
specifically referenced herein

1 conditions governing the sale of Mortgage Loans under the Loan Purchase Agreement.²
2 The MLPSA, the Loan Purchase Agreement and the Seller Guide are collectively
3 referred to herein as the "Agreements."
4

5 7. Pursuant to the Agreements, the Debtor conveyed, transferred and
6 assigned all right, title, and interest in and to the Mortgage Loans to Wells Fargo
7 Funding, including, without limitation, the corresponding servicing rights on a servicing
8 released basis. See Seller Guide at 310.01, 13; MLPSA Exhibit 4, ¶ 1. Additionally,
9 pursuant to the Agreements, Wells Fargo Funding was vested with beneficial ownership
10 of the Mortgage Loans and the related mortgage notes. MLPSA §§ 6.02.
11

12 8. Subsequent to the sale of Mortgage Loans from the Debtor to Wells
13 Fargo Funding, the Debtor would typically serve as interim servicer of the Mortgage
14 Loans for a brief period (the "Interim Servicing Period") (generally not more than 30 to
15 60 days) until such time as Wells Fargo Funding could transition servicing to the
16 permanent servicer, Wells Fargo Bank, N.A. (collectively with Wells Fargo Funding,
17 "Wells Fargo"). MLPSA § 6.02; MLPSA Exhibit 11, § 11.01. In many cases, after
18 purchasing the Mortgage Loans from the Debtor, Wells Fargo Funding would sell the
19 Mortgage Loans to third-party investors (the "End Investors") and Wells Fargo Bank,
20 N.A. would act as the permanent servicer of the Mortgage Loans.
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23 9. In its capacity as interim servicer, the Debtor collected principal
24 and interest and escrow payments owing to taxing authorities and insurance carriers
25 from end-borrowers under the Mortgage Loans and held such collections as custodian
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28 ² Due to its voluminous and proprietary nature, Wells Fargo Funding has not attached hereto the Seller Guide as an exhibit. Wells Fargo Funding will provide a copy of the Seller Guide to the Court upon request.

1 for Wells Fargo Funding during the Interim Servicing Period. MLPSA § 6.02. After
2 servicing of the Mortgage Loans had been transitioned to Wells Fargo Bank, N.A., the
3 Debtor's servicing rights terminated, and the Debtor was required to deliver to Wells
4 Fargo all principal and interest payments and any escrow payments collected by it from
5 end-borrowers during the Interim Servicing Period. MLPSA § 15. Upon receipt of the
6 principal and interest and escrow payments from the Debtor, Wells Fargo applied
7 monies to the end-borrowers' loan accounts, forwarded interest payments to End
8 Investors, and paid insurance carriers and taxing authorities on behalf of end-borrowers.
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10
11 10. As of the Petition Date, the Debtor was holding approximately
12 \$207,514.15 in escrow funds (the "Escrow Funds") that it collected as interim servicer
13 during the Interim Servicing Period in respect of Mortgage Loans purchased by Wells
14 Fargo, that were never turned over to Wells Fargo. As a consequence of the Debtor's
15 failure to timely turnover the Escrow Funds, Wells Fargo was required to go out-of-
16 pocket to pay various insurance carriers and taxing authorities on behalf of end-
17 borrowers in the amount of the Escrow Funds in order to prevent such end-borrowers'
18 accounts from becoming delinquent.
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21 11. Since the Petition Date, Wells Fargo Funding has worked patiently
22 and in good faith with the Debtor in order to recover the Escrow Funds, expending
23 significant time and financial resources. Nevertheless, such efforts have been
24 unsuccessful and the parties have not be able to come to terms for the turnover of the
25 Escrow Funds.
26

27 12. Upon information and belief, the Escrow Funds have been
28 commingled in a prepetition bank account (containing approximately \$3.8 million as of

1 the Petition Date) in which other third party institutional investors have asserted an
2 interest (the "Prepetition Funds"). See Disclosure Statement at V.C (disclosing the
3 existence of the Prepetition Funds).

4
5 13. The Plan is silent, however, with respect to the Debtor's position
6 regarding ownership of the Prepetition Funds, whether such funds will be segregated
7 from the Dividend Fund (as defined in the Plan) or whether such funds will be used to
8 fund distributions under the Plan.

9 10 ARGUMENT

11 14. Section 1129(a)(1) of the Bankruptcy Code provides that a plan of
12 reorganization can only be confirmed if "[t]he plan complies with the applicable
13 provisions of this title." 11 U.S.C. § 1129(a)(1). It is well settled that a bankruptcy
14 court does not have jurisdiction to direct the disposition of property that does not
15 comprise property of a debtor's bankruptcy estate. See In re Pentell, 777 F.2d 1281,
16 1285 (7th Cir. 1985) (holding that the bankruptcy court did not have jurisdiction over
17 insurance proceeds absent evidence that the debtor had an interest in such proceeds); In
18 re Xonics, Inc., 813 F.2d 127, 131 (7th Cir. 1987) (holding that the purpose of
19 bankruptcy court jurisdiction is to apportion the debtor's assets among its creditors and
20 therefore, the bankruptcy court has no jurisdiction over non-estate assets); In re
21 Holywell Corp., 118 B.R. 876 (S.D. Fla. 1990) (finding that the bankruptcy court does
22 not have jurisdiction over property belonging to another party absent a finding that the
23 property also constitutes a part of the debtor's estate); In re Ridgely Communications,
24 Inc., 139 B.R. 374, 380 (Bankr. D. Md. 1992) (noting that assets not comprising part of
25 debtor's estate are not subject to a bankruptcy court's jurisdiction). Because the Escrow
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1 Funds are not property of the Debtor's estate, this Court is without jurisdiction to
2 authorize the distribution of the Prepetition Funds under the Plan, and the Plan, to the
3 extent it seeks to distribute the Prepetition Funds, cannot be confirmed.

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5 15. Section 541(a) of the Bankruptcy Code broadly defines property of
6 the estate as "all legal or equitable interests of the debtor in property as of the
7 commencement of the case." 11 U.S.C. §§ 541(a)(1); Begier v. Internal Revenue
8 Service, 496 U.S. 53, 59 (1990) (holding that property in which the debtor has no
9 interest is not property of the estate). With respect to ownership of the Escrow Funds,
10 the Agreements leave no doubt – Wells Fargo Funding owns all right, title and interest
11 in and to the Mortgage Loans, the corresponding servicing rights and loan documents,
12 and all proceeds collected on account of such Mortgage Loans, including the Escrow
13 Funds. The Debtor retained no interest - equitable, legal or otherwise - in the Mortgage
14 Loans or the Escrow Funds and therefore, the Escrow Funds do not comprise part of the
15 Debtor's bankruptcy estate.

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17 16. Wells Fargo Funding's exclusive ownership rights in the Escrow
18 Funds is further evidenced by the Agreements, which expressly provide that the Debtor
19 holds any Escrow Funds as "custodian" for Wells Fargo Funding and is required to
20 immediately turnover any such funds in its possession to Wells Fargo Funding upon
21 termination of the Interim Servicing Period. MLPSA §§ 6.02, 15.

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23 17. In addition, the Escrow Funds do not become property of the
24 Debtor's estate simply because they have been commingled with funds in which other
25 third party institutional investors have asserted an interest. Under well settled tracing
26 principles, to recover the Escrow Funds, Wells Fargo Funding may have to establish its
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1 rights to the Escrow Funds vis-à-vis other creditors who also claim an interest in the
2 Prepetition Funds. But the commingling of the Escrow Funds with other Prepetition
3 Funds does not, however, transform the Escrow Funds into property of the estate. See
4 Old Republic Nat'l Ins. Co. v. Tyler (In re Dameron), 155 F.3d 718, 723-24 (4th Cir.
5 1998) (holding that creditor, whose funds have been commingled in debtor's general
6 operating account, is entitled recover such funds using equitable method of tracing);
7 Official Committee of Unsecured Creditors of Columbia Gas Transmission Corp. v.
8 Columbia Gas Systems, Inc. (In re Columbia Gas Systems, Inc.), 997 F.2d 1039, 1064
9 (3d Cir. 1993) (holding that equitable tracing principles allow a creditor to recover
10 funds from a commingled account); In re Supermarkets of Cheltenham, 1999 WL
11 260956 (Bankr. E.D. Pa. 1999) (same).

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15 18. Because the Escrow Funds do not comprise part of the Debtor's
16 bankruptcy estate, this Court lacks jurisdiction to authorize the Debtors to distribute
17 such funds under the Plan. Thus, to the extent the Debtor asserts an ownership interest
18 in the Prepetition Funds, including the Escrow Funds, and intends to use such funds to
19 make distributions under the Plan prior to a judicial determination being made regarding
20 the parties' relative rights in such funds, Wells Fargo Funding respectfully requests that
21 this Court deny confirmation of the Plan.

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23 19. Wells Fargo Funding further submits that confirmation of the Plan
24 is inappropriate absent the Plan and/or the confirmation order providing that the
25 Prepetition Funds, which include the Escrow Funds, shall be segregated from the
26 Dividend Fund and held in trust pending a final resolution of the relative rights of all
27 parties asserting an interest in the Prepetition Funds.
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Court deny confirmation of the Debtor's Plan.

Dated this 4th day of February, 2008.

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1 ORIGINAL electronically filed with the
2 U.S. Bankruptcy Court on this 4th day of
3 February, 2008.

4 COPIES mailed this 4th day of
5 February, 2008, to:

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